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The Alberta MURB

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Tax incentives associated with the construction of multiple unit residential buildings have recently been reintroduced by the federal government. Before this reintroduction, the government of Alberta put in place a provincial tax incentive also based on MURB construction. In this article, the author compares the two programs and outlines their combined effect.

Industry in Alberta, particularly the oil and gas industry, has come to believe that the failure of the governments of Canada and Alberta to co-ordinate their "intervention" into the private sector can have only harmful effects. Tax incentives associated with the construction of multiple unit residential buildings ("MURBs"), however, are perhaps one area where the Ottawa-Edmonton communication barrier has produced a positive result from industry's point of view.

In response to the termination of the federal MURB tax incentive program on December 31, 1979, the Alberta government introduced the Rental Investment Incentive Program ("the Alberta MURB program") on May 1, 1980.[1] The program provides for a tax credit or rebate from the provincial government for the construction of MURBs in Alberta. In the budget speech on October 28, 1980, the federal Minister of Finance announced the reintroduction of the federal MURB incentive program.[2] As a result, MURB construction in Alberta commenced from October 28, 1980 to December 31, 1981 will give rise to a claim under both the federal and provincial schemes.

History of the Federal MURB

To encourage the construction of rental accommodation, the federal Minister of Finance announced on November 18, 1974 the creation of two new Classes of capital property—namely, Classes 31 and 32. Class 31 included multiple unit residential buildings generally, depreciable at the rate of 5 per cent per year on a diminishing balance basis, while Class 32 included multiple unit residential buildings of frame construction depreciable at a 10 per cent rate.[3] Although originally designed to expire on December 31, 1975, the program was ultimately extended in one form or another to December 31, 1979. In the early years, a program of grants from the Central (now Canada) Mortgage and Housing Corporation ("CMHC") was also in force. This was later converted

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[1] Introduced as part of Bill 41, The Alberta Corporate Income Tax Act, and Bill 42, The Alberta Income Tax Amendment Act, 1980.

[2] See Canada, Department of Finance, "Supplementary Information," in *Budget Papers* (Ottawa: the Department, October 28, 1980), 104. To the date of writing, no resulting amendment to Schedule II of the Income Tax Regulations (Canada) has been passed.

[3] The definitions of the classes referred to property that would otherwise be included in Class 3 or Class 6, as the case may be.

to a system of interest-free loans. By January 1, 1980, the construction of MURBs did not give rise to any specific federal tax advantage.[4]

The effect of the federal incentive has been to allow taxpayers to offset any form of income with capital cost allowance claims for Class 31 and Class 32 assets. Since 1972, rental properties other than qualifying MURBs have been subject to restrictions on the deduction of capital cost allowance contained in Part XI of the Regulations to the federal Income Tax Act (respectively referred to hereafter as the "federal Regulations" and the "federal Act"). Pursuant to federal regulation 1100(11), the capital cost allowance claim on rental property is limited to the taxpayer's income from such property; it is therefore not possible to shelter other income by means of the ownership of rental property other than qualifying MURBs.

Since the federal incentive took the form of a capital cost allowance claim, it provided the possibility of tax shelter benefit for a number of years. While the tax shelter was normally greatest in the first year because of claims for soft costs such as financing costs, landscaping, and off-site services, claims in subsequent years could also be substantial, particularly where the rental project was operating at a deficit, which was not an uncommon situation. Many MURB syndication offerings do not in fact project a positive cash flow until the sixth to eighth year of operation. Nevertheless, the soaring value of real estate, and the limited number of tax shelters available, caused MURB syndications to proliferate through to 1979.

With the termination of the federal incentive and record high interest rates in 1980, MURB construction dropped substantially. It was against this background that the Alberta government, faced with a large population influx, found itself in serious need of rental accommodation.

THE ALBERTA LEGISLATION

The Alberta MURB program was introduced on May 1, 1980 as part of Bill 41, The Alberta Corporate Income Tax Act, and Bill 42, The Alberta Income Tax Amendment Act, 1980. While amended somewhat in passage, section 25 of The Alberta Corporate Income Tax Act, entitled the "Alberta Rental Investment Tax Credit," received Royal Assent along with the balance of Alberta's new corporate tax statute on May 22, 1980 and came into force on January 1, 1981.

Section 6 of The Alberta Income Tax Amendment Act, 1980, also entitled the "Alberta Rental Investment Tax Credit," was struck out entirely on May 12, 1980. This was necessary because, contrary to earlier indications, Ottawa had advised Edmonton that it was not prepared to administer the new program as part of Ottawa's overall administration of Alberta's individual tax system. Accordingly, the Alberta government had no choice but to remove the provision from the Act before passage. In its place, on June 11, 1980 the Lieutenant Governor in Council filed the Alberta Rental Investment Grants Regulation pursuant to The Department of Housing and Public Works Act. The legislation is virtually identical to that which would have been included in The Alberta Income Tax Act, but its removal from that statute means that the incentive takes the form of a grant from the Minister of Housing and Public Works for Alberta rather than a reduction of Alberta income taxes payable. As a result, a new branch has hastily been

[4]Taxpayers were still able to write off the soft costs of construction such as financing costs, landscaping, legal fees, and property taxes. In addition, the building itself would generally qualify as a Class 3 asset and as such would be depreciable at the rate of 5 per cent per annum, subject, however, to the rental property restrictions contained in regulation 1100(11).

created within the Department of Housing and Public Works to administer the program. This last-minute change of plans, it is feared, may result in substantial delays and duplication of administrative effort in the operation of the program in the case of noncorporate taxpayers.

QUALIFYING ALBERTA MURB

Paragraph 25(1)(c) of The Alberta Corporate Income Tax Act (the "Alberta Act") and paragraph 1(1)(f) of the Alberta Rental Investment Grants Regulation (the "Alberta Regulation") contain substantively identical definitions of "qualifying Alberta multiple unit residential building."[5] In order to qualify, the building must meet the following general tests.

1) It must be a multiple unit residential building included in Class 3, 6, 31, or 32 of Schedule II of the federal Regulations.

2) The footings must be installed during the 1980 or 1981 calendar years.

3) A certificate of eligibility must be obtained from the Alberta Home Mortgage Corporation ("AHMC").

4) At least 80 per cent of the floor space must be used for self-contained domestic establishments and related amenities.

5) A certificate of completion must be obtained from AHMC.

From these requirements, it can be seen that there are two deviations from the federal rules. Firstly, AHMC is the certifying authority rather than CMHC, and secondly, the concept of a certificate of completion is introduced. Draftsmen of the Alberta legislation perceived a flaw in the federal rules that provided little incentive for developers to complete projects quickly; with the critical factor being to have the footings poured in time, there were a number of buildings that were not completed for some time, if at all. Therefore, to bring the rental units onto the market as quickly as possible, a certificate of completion must be obtained for the provincial incentive to be available. Provincial officials acknowledge the danger of some shoddy workmanship from efforts to complete a building within a particular taxation year. Because the incentive can be carried forward, however, they feel the danger is not significant.

MAXIMUM ELIGIBLE INCENTIVE

Paragraphs 25(1)(b) and 1(1)(e) of the Alberta Act and the Alberta Regulation,

[5] In the case of the Alberta Act, the legislation reads as follows:

> "qualifying Alberta multiple unit residential building" means a property that is a multiple unit residential building in Alberta that is or would, but for the operation of Classes 31 or 32 of Schedule II of the federal regulations, be included in Classes 3 or 6 of Schedule II of the federal regulations and in respect of which
>
> (i) a certificate of eligibility has been issued by the Alberta Home Mortgage Corporation certifying that the installation of footings or any other base support of the building was commenced after December 31, 1979 and before January 1, 1982, and that, according to plans and specifications for the building, not less than 80% of the floor space will be used in providing self-contained domestic establishments and related parking, recreation, service and storage areas,
>
> (ii) a certificate of completion has been issued by the Alberta Home Mortgage Corporation to the corporation, and
>
> (iii) immediately after the certificate of completion has been issued, not more than 20% of the floor space is used for any purposes other than those referred to in subclause (i)
>
> but does not include property
>
> (iv) the cost of which is deductible in computing the corporation's income,
>
> (v) that is described in the corporation's inventory, or
>
> (vi) that was not acquired by the corporation for the purpose of gaining or producing income;

respectively, set out the meaning of the "maximum eligible incentive" as follows:

> "maximum eligible incentive" means, for each qualifying Alberta multiple unit residential building of a corporation, the lesser of
>
> (i) 5% of the amount invested by the corporation in that qualifying Alberta multiple unit residential building, and
>
> (ii) the amount determined by multiplying $3000 by
>
> (A) the number of residential units owned by the corporation in the qualifying Alberta multiple unit residential building, or
>
> (B) where paragraph (A) is inapplicable, the product obtained when the proportion that the amount invested by the corporation is of the total capital cost of the qualifying Alberta multiple unit residential building is multiplied by the number of residential units in the qualifying Alberta multiple unit residential building;

The maximum eligible incentive is generally 5 per cent of the capital cost of the building. As will be demonstrated later in this paper, because the incentive takes the form of a grant to individuals and a tax credit to corporations, it is equivalent to a 10 per cent capital cost allowance claim in the first year for a 50 per cent rate taxpayer.

The incentive is limited to $3,000 per residential unit, As a result, units having a capital cost in excess of $60,000 will not qualify for any greater incentive than would a $60,000 unit. Government officials have indicated the following reasons for imposing the $60,000 ceiling.

1) The Alberta government does not wish to be seen to be encouraging the construction of luxury rental accommodation through tax incentives.

2) Based on empirical data, $60,000 includes the vast majority of rental units when one remembers that this figure is net of land costs and soft costs.

3) The rate of return on luxury rental accommodation is such that less government assistance is required in that area; it is with respect to lower and middle cost units that it is more difficult to generate a profit.

A potential difficulty arises with respect to the application of the ceiling to a group of investors constructing a building that contains units with capital costs under $60,000 as well as units with capital costs over $60,000. If the syndication of the investors is done by way of an investor's direct ownership of a particular suite, then those investing in the higher priced units will be subject to the ceiling while those investing in the lower priced units will not. This will cause the rate of return on investment to differ from one investor to another in the same project, a result that most promoters of syndicated offerings attempt to avoid.

If, on the other hand, the syndication is structured by way of undivided interests in the entire building or by way of partnership interests, there should be no discrepancy. As long as the total capital cost of the building divided by the number of suites does not exceed $60,000, the ceiling would not apply. If this quotient does exceed $60,000, then presumably the syndication agreement could provide that the amount of credit available would be shared pro rata among investors based on the amount invested.

Tax Reduction

The provisions of the Alberta Act and the Alberta Regulation necessarily differ as to the form of the incentive provided. Subsection 25(3) of the Act reads as follows:

> A corporation may reduce the amount of tax that it would be required to pay under this Part after complying with sections 21, 22, 23 and 24 by an amount equal to the lesser of
>
> (a) the amount, if any, by which the aggregate of the maximum eligible incentive for all qualifying Alberta multiple unit residential buildings of the corporation exceeds the aggregate of all tax credits allowed in a previous taxation year to the corporation under this section, and
>
> (b) the tax payable under this Act after claiming the deductions under sections 22, 23 and 24.

The following points are of note in relation to this provision.

1) The incentive takes the form of a nonrefundable credit against provincial corporate taxes payable; if there are insufficient taxes payable in a given year, the credit may be used in subsequent years.

2) The calculation of the credit is on a cumulative basis; that is, the corporation determines the aggregate incentive for all qualifying Alberta MURBs *ever* owned by it (regardless of whether they have subsequently been disposed of) and then subtracts the total of all credits previously claimed in order to determine its credit for the year in question.[6]

3) The credit is optional, not mandatory.[7]

4) The corporation need not include any royalty tax credit it may be entitled to in calculating its tax payable under the Act under paragraph (b); this follows from the fact that the royalty tax credit is claimed under section 26, which is not enumerated in the paragraph (b) limitation quoted above.[8]

Subsection 6(1) of the Alberta Regulation sets out the form of incentive for noncorporate taxpayers as follows:

> An individual who has, in a taxation year, invested in a qualifying Alberta multiple unit residential building, may apply on the form prescribed by the Minister and available from the Department and from the Alberta Home Mortgage Corporation for a grant not exceeding the lesser of
>
> (a) the amount, if any, by which the aggregate of the maximum eligible incentive for all qualifying Alberta multiple unit residential buildings of that individual exceeds the aggregate of grants made to that taxpayer in a previous taxation year under this regulation, and
>
> (b) the tax payable with respect to that taxation year under The Alberta Income Tax Act before section 8.3 and 8.5 of that Act are applied.

While the intention of the program is certainly that noncorporate and corporate MURB investors be treated equally, two significant discrepancies arise.

1) Noncorporate investors must make a formal application for this grant, whereas corporate taxpayers need only complete the appropriate schedule to their tax returns.[9]

2) Noncorporate investors who completed an Alberta MURB in 1980 will be entitled to claim their grants in the spring of 1981, as soon as they are in a position to determine their 1980 provincial taxes payable; because the Alberta Corporate Income Tax Act only applies to taxation years commencing after 1980, most corporate investors will not be in a position to claim

[6]The writer of this paper pointed out to the draftsmen of the legislation that a court of law, faced with the phrase "all qualifying Alberta multiple unit residential buildings of the corporation" might well conclude that only buildings owned by the corporation at the time would qualify. While acknowledging the possibility, these officials were of the view that the overall intention of the legislation was clear in that the corporation, which in fact built the MURB, as evidenced by its name appearing on the certificate of completion, was entitled to the credit irrespective of the fact that it may have disposed of the building at a later date.

[7]While in most cases investors would choose to utilize the credit as soon as possible, the optional nature does insure that if for any reason (including oversight) the credit is not claimed, it will not be permanently lost.

[8]The royalty tax credit, often referred to as the "small explorer's tax credit," is a cash refundable credit generally equal to 25 per cent of Alberta resource royalties paid, subject to a $1 million annual limitation. A corporation having insufficient provincial taxes payable to fully utilize both its Alberta rental investment tax credit and its royalty tax credit may therefore reduce its provincial taxes payable by the former while claiming a cash refund, to the extent necessary, for the latter.

[9]This, of course, stems from the federal government's refusal to administer the plan as part of the individual tax system.

their tax credits until well into 1982, regardless of when construction was completed.[10]

PROCEDURES FOR OBTAINING INCENTIVE

Syndication promoters and individual and corporate investors, as well as their legal and accounting advisers, should be aware of the procedure to be followed to obtain the benefits of the Alberta MURB program. The procedure for both individuals and corporations begins as follows.

1) The Alberta Home Mortgage Corporation should be contacted, preferably before the footings are installed, to obtain an application for footing inspection. Once the application has been prepared and filed with AHMC, arrangements should be made for inspection of the footings. When this has been done, a notification of eligibility (referred to in the legislation as a certificate of eligibility) should be obtained from AHMC.

2) When the building is substantially complete and ready for occupancy, an application for certification should be filed with AHMC. (This application form should be secured when obtaining the application for footing inspection.) If the building is owned by more than one person at the time of its completion, an ownership agreement should be filed along with the application for certification. This form (which is also provided by AHMC at the outset) sets out the respective interests of the owners of the building. If a municipal occupancy permit has been obtained from the municipality, it should also be filed with AHMC. If no permit is available, AHMC will inspect the building. Once these steps are completed, a certificate of completion will be issued. It is important to verify that the name of each person intending to claim a grant or tax credit appears on the certificate of completion. No grant or credit will be available to any person whose name does not appear.

At this point in the process, the procedure differs for individuals and corporations. Individuals must contact Alberta Housing and Public Works and obtain an application for rebate form and a rebate eligibility form. Once completed, these forms must be filed with Alberta Housing and Public Works, together with supporting documentation relating to the amount of income taxes payable in the relevant year. This latter requirement precludes the possibility of claiming the rebate until the individual's tax assessment for the year is complete. Individuals requiring further information should contact the Director of the Alberta Rental Investment Incentive Program, Alberta Housing and Public Works.

Corporations need not contact any government body at this stage. Instead, they simply complete Schedule 3 to their Alberta corporate income tax returns for the relevant year and enclose the required supportive documentation (most importantly a copy of the certificate of completion and the ownership agreement, if any). Corporations that require additional information should contact the Corporate Tax Administration branch of the Alberta Treasury.

EXAMPLE OF CALCULATION

In order to illustrate the operation of the Alberta MURB incentive, consider the case of an Alberta resident individual at the top marginal rate investing \$100,000 in an Alberta MURB.

Allocation of Costs:

Land	\$ 25,000
Building	60,000
Soft costs	15,000
	\$100,000

Alberta Rental Investment Rebate:
Lesser of:

(a) \$3,000, and

(b) \$60,000 x 5% = \$3,000

[10] In numerical terms, Alberta housing officials advise that the timing advantage has not proven significant, since only about 20 projects have been certified as completed within the 1980 calendar year.

From this simplified example, it can be seen that the incentive payment is only 3 per cent of the amount invested. If, however, one considers that most investors would finance the majority of their investments and that there are also tax savings associated with the investments, the attractiveness of the transaction improves considerably, as is shown by the following calculation:

Allocation of costs	=	as above
Alberta MURB rebate	=	$3,000
Amount financed	=	75% or $75,000

Tax deduction:

Soft costs	= $15,000 @ 100% =	$15,000
CCA	= $57,000 @ 5% =	2,850
		$17,850

Tax saving:
$17,850 x 59.5% (43% x 38.5%) = $10,621

Cash position, end Year 1:

Outlay	$25,000
Tax saving	(10,621)
Alberta MURB rebate	(3,000)
Net cost of investment, Year 1	$11,379

For capital cost allowance purposes, the capital cost of the building is reduced by the amount of the provincial incentive from $60,000 to $57,000 pursuant to subsection 13(7.1) of the federal Act. The $11,379 figure would compare to a net cost of investment of $14,290 in Year 1, when there was no Alberta MURB incentive.[11]

The above example illustrates that almost the entire $3,000 credit effectively goes to the investor in the first year, thereby decreasing his initial investment cost by a significant 20 per cent. In fact, an investment model prepared for a Department of Housing seminar that outlines the operation of the Alberta MURB incentive indicates that, assuming Alberta government financing is obtained under the provincial CHIP program,[12] 50 per cent marginal rate taxpayers would find themselves in a positive cash position beginning immediately in Year 1.[13] That is, the aggregate of these taxpayers' Alberta MURB credits, tax savings, and initial operating revenue would exceed the amount of their investments. This result is a major sales tool for all MURB syndication promoters.

POLICY CONSIDERATIONS

The obvious policy objective of the Alberta MURB program is to encourage the construction of rental accommodation in the province. With vacancy rates in Edmonton and Calgary ranging from 1 to 2 per cent and with thousands of people arriving each month, one cannot dispute the need for more rental accommodation. There are, however, certain related policy issues that require more careful scrutiny.

[11] Calculated as follows:

Tax reduction:

Soft costs	= $15,000 @ 100% =	$15,000
CCA	= $60,000 @ 5% =	3,000
		$18,000

Tax saving:
$18,000 x 59.5 % = $10,710

Cash position, end of Year 1:

Outlay	$25,000
Tax saving	(10,710)
Net cost of investment, Year 1	$14,290

[12] Core Housing Incentive Program; in order to qualify for the current 8.75 per cent interest rate under this program, 50 per cent of the suites must be subject to restrictions on rental rates and qualifying tenants.

[13] Prepared by W. P. Haye and H. R. Henderson, Peat, Marwick, Mitchell & Co., Edmonton.

The introduction of the Alberta MURB program and The Alberta Corporate Income Tax Act coincided well. The Alberta government was looking for reasons to justify the introduction of its corporate tax statute because of the substantial administrative costs and added reporting requirements that were involved. The Alberta MURB program served as a convenient, universally popular example of what could be accomplished through a provincially administered tax system. The federal government, by refusing to administer the noncorporate aspect of the program, further strengthened the provincial government's position. The manner in which the Alberta government chose to implement the noncorporate aspect of the incentive does, however, illustrate that it was not necessary to introduce an entire corporate tax statute merely to implement the Alberta MURB program. A regulation passed pursuant to any one of a number of existing provincial statutes would have sufficed.

The Alberta government's choice of a one-time-only credit system of incentive rather than an ongoing claim for capital cost allowance is an interesting one. Albertans are very familiar with up-front write-offs in the context of oil and gas drilling funds, and the 100 per cent write-off of Canadian exploration expenses has been the cornerstone of drilling activity for several years. The great advantage of a one-time credit, as is witnessed by the oil and gas experience, is that investors have no choice but to continue investing if they hope to maintain their advantageous tax positions. Unfortunately, in the Alberta MURB context, the December 31, 1981 expiry date will militate against continued investment.[14]

Interest rates in the range of 20 per cent per annum are a major deterrent to financed construction. The impact of the Alberta MURB program will likely be minimal unless carrying costs in the construction industry can be reduced significantly. Therefore, a provincial system of rental construction financing at reasonable rates and with no strings attached as to unit sizes, eligible renters, etc., would undoubtedly generate the higher degree of interest in MURB construction that is lacking at present.

CONCLUSION

When combined with the reintroduction of the federal MURB, the Alberta Rental Investment Incentive Program significantly reduces the cost of investment for the construction of multiple unit residential buildings in Alberta. Although the time for investing is short, interest rates remain high, and the administration of the program is likely to be troublesome, investors who are able to qualify will probably realize the best return on investment of any MURB investors to date.

[14] The writer of this paper attempted, without success, to obtain some indication of the likelihood of the extension of the program from provincial government officials. Certainly, the reintroduction of the federal MURB incentive reduces that likelihood.